

**Municipal Bond Rating Reform**  
**Message to Underwriter and Financial Advisor Pools**  
**California State Treasurer Bill Lockyer**  
**March 24, 2008**  
**(sent via email)**

As you are probably aware, Treasurer Lockyer has been leading a national effort to persuade the rating agencies to change the way they rate municipal bonds. Munis are held to a much higher standard than corporate bonds, as the rating agencies' own default studies demonstrate. This unjustifiable system has cost taxpayers billions of dollars. It also helped trigger the meltdown in our VRDB market when several of the bond insurers suffered downgrades below the minimum ratings required for money market eligibility.

Three weeks ago, the Treasurer took the lead in writing a letter to the rating agencies requesting that they change the way in which they rate municipal bonds. The letter was signed or endorsed by 13 state treasurers, as well as four other state and local municipal issuers across the country. (Attached are a copy of the letter and an article about the letter from the New York Times.) Since the letter was sent to the agencies, other major issuers have backed the effort, as has the nation's largest public pension fund (California Public Employees' Retirement System). Additionally, key members of Congress, including the chairman and other members of the House Committee on Financial Services, have strongly criticized the way the rating agencies evaluate municipal credits.

We have seen an open-minded response to this issue from Moody's and Fitch. Moody's, in particular, stated in a Request for Comment issued last week (and also attached to this email) that, beginning in May, it plans to assign its Global Scale Rating (GSR) to any municipal bond upon the request of the issuer. It also requested that market participants comment on this change by April 15.

The Treasurer plans to respond positively, with at least three caveats. First, we hope this is the first step toward the assignment of a single rating determined on a global scale basis. The assignment of two ratings may be confusing, but is certainly an improvement over the current situation. Second, we hope that Moody's will figure out a way to ensure that its GSR can be the rating applicable for purposes of satisfying SEC Rule 2a-7. If necessary, Moody's might assign only a GSR to variable rate bonds.

Finally, we believe that Moody's should not charge issuers an extra fee for the GSR. Under Moody's' current practice of assigning a GSR to taxable bonds, Moody's charges an additional fee equal to one basis point of par. This greatly discourages issuers from requesting the rating. If the GSR is to be commonly used, Moody's cannot impose an additional charge to assign it.

The Treasurer believes that correcting the way in which municipal bonds are rated is extremely important to taxpayers in California and around the country. But it's also important to investors, broker dealers and all other market participants interested in a

market that functions efficiently and openly on the basis of a true measure of an issuer's likelihood of default.

In our discussions with the rating agencies, they've claimed that their rating approach is responsive to the market and that the market likes things the way they are. Moody's, in its Request for Comment, acknowledges that is changing. It is important that a wide range of market participants make it clear to the rating agencies that the current system is unfair to taxpayers and detrimental to the market. The Treasurer urges you to respond to the Moody's request for comment.

We also urge you to make your opinions known to the other rating agencies. If you are willing, we'd appreciate a copy of your communication to the agencies. Thank you.